

Goals for 2010 & beyond

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2010 PLA CONFERENCE - SPIER - WESTERN CAPE
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- Speaker* Pierre Pretorius
- Company* Old Mutual
- Topic* Governance agreements –
The trustees / sponsor conundrum

WITHOUT SPONSORS WE WON'T HAVE PENSION FUNDS

- **Sponsors are the driving forces behind the establishment of retirement funds registered under the Pension Funds Act**
- **The main sponsors of retirement funds are relatively large employers, trade unions and insurance companies or other providers of financial products**
- **The focus of this talk will be on commercial retirement funds, but much of what is stated can be applied to funds sponsored by employers and trade unions**

COMMERCIAL FUNDS PLAY VITAL ROLE

- Commercial funds play a major role in giving individuals and the employees of smaller and medium sized employers access to the cost-efficiencies and good governance that a large fund can offer through scale and advanced systems
- According to the National Treasury, Social Security and Retirement Reform, 2nd Paper, there are more than 13,500 private pension funds which add considerably to the regulatory workload and administration costs
- The Paper thus recommends measures that would encourage the consolidation of smaller funds into multi-employer funds and as such add a further significance to the future role of commercial funds in providing retirement solutions

SPONSOR VITAL TO THE SUCCESS OF A FUND

The sponsor contributes materially to the success of a commercial fund by

- Developing and maintaining the necessary IT-systems for the fund
- Developing appropriate investment products for members
- Training the staff needed for the efficient operation of the fund
- Providing professional services, such as actuarial, investment consulting and legal services
- Marketing and distributing the products of the fund

SPONSOR & TRUSTEES RELATIONSHIP VITAL

- Contrary to the position regarding the administrator and other service providers, the role of the sponsor surprisingly lacks formality and regulation
- PF 130 however recognises that the board is accountable to the sponsor and owes the sponsor a good faith duty [par 6 & 66]
- The sponsor plays an important role in the success of a fund and in this regard its relationship with the trustees is vital to the good governance and success of the fund – if this relationship fails, the fund is bound to fail.

MATTERS THAT REQUIRE SPECIAL ATTENTION

The following matters require special attention:

- the oversight role of the trustees in regard to the strategy of the fund, the products offered to members, the marketing and distribution of products
- conflicts of interest
- the accountability of the trustees towards the sponsor
- the good faith duty of the sponsor as a mandatary of the fund.

COMPARABLE RELATIONSHIPS

- A comparable relationship exists between shareholders and directors where one deals with
 - the fiduciary duty of the board towards the company and the commercial interests of shareholders
 - the accountability of the board to the shareholder
- To address these issues various companies have entered into relationship agreements with shareholders and/or developed governance models which focus on the relationship between the parties

RESOLVE THE CONUNDRUM THROUGH DISCUSSION AND NEGOTIATION

- We as South Africans have a wonderful live example of parties, with vastly diverging interests and constituencies, discussing and negotiating a new governance model for South Africa in a well-structured process
- The same success recipe can be used by the trustees and sponsor of a fund to find solutions for the conundrum of reconciling their sometimes varying interests and perspectives by way of well-structured discussions and negotiations aimed at achieving agreement on an appropriate governance model for the fund

SPONSOR & TRUSTEES IN A SYMBIOTIC RELATIONSHIP

- The point of departure in negotiating the agreement should be to accept that the trustees and sponsor
 - have a common goal and a shared responsibility in ensuring the commercial success of the fund
 - find themselves in a symbiotic relationship, where the one cannot make the fund work without the other
 - but, without being blind to the fact that differences might arise on critical issues and need to be addressed sensibly
- The approach that Trustees be involved in the commercial success is in line with the risk-based supervision approach of the FSB, namely the acceptance that the viability of a fund is affected by its success in attracting and retaining members and participating employers

STRUCTURED PROCESS VERY IMPORTANT

- All important issues should carefully be looked into the eye by the parties
- The issues must be discussed in a structured way and in an environment of openness and in a spirit of goodwill and good faith
- The objective should be for the negotiations ultimately to culminate in a governance agreement to guide the relationship into the future
- The process of discussion and negotiation is as important, if not more important than the ultimate governance agreement.
- It is during this process that the parties will be able to create mutual understanding of their respective perspectives on critical issues.
- The sponsor will gain an understanding of the oversight role of the trustees and the trustees of the commercial realities facing the sponsor.

MATTERS TO BE DISCUSSED AND AGREED

The matters to be discussed and agreed upon include the following:

- Recognition of the sanctity of the independence of the trustees, the fiduciary duties of the trustees and the oversight role of the trustees
- The accountability of the trustees towards the sponsor
- Recognition of the significant role of the sponsor in ensuring the success of the fund and fairly catering for the commercial interests of the sponsor
- Measures aimed at ensuring market-related products and high service levels
- Providing for appropriate remedies and dispute resolution mechanisms

THE REMEDIES

- The issue of appropriate remedies for breaches requires special attention
- A vexed question is whether the trustees should be able to terminate the fund's relationship with the sponsor and, if so, in what circumstances.
- Termination should in my view not be an option due to
 - the close link between the fund and the sponsor,
 - the commercial realities; and
 - the protection provided by the availability of competing retirement funds to which members can transfer if they are unhappy with the fund
- Appropriate remedies should rather be found in the remedies of specific performance and damages.

AGREEMENT TO BE A LIVING DOCUMENT

- The governance agreement should be a living document that is regularly reviewed following the same process of first discussing the concerns of the parties and then negotiating an appropriate solution.
- Ideally funds should create a consultative forum where the trustees and sponsor of the fund in question can regularly discuss governance and other issues concerning the fund openly and candidly.

COMPLEMENTARY MEASURES

- **Good governance of commercial funds requires a comprehensive package of complementary measures**
- **In addition to a proper governance agreement, such measures should include**
 - **appointing top level trustees with complementary skills and a good balance between independent trustees and sponsor affiliated trustees (assuring a sound understanding of and access to the business of the sponsor)**
 - **a competent principal officer with adequate staff, appointed and employed by the fund**
 - **a healthy competitive environment which will enable the members of commercial funds to vote with their feet if they are unhappy**

ESSENCE OF GOOD GOVERNANCE

The Hampel Report (slightly amended to cater for retirement funds) crisply observed:

“Good governance is not just a matter of prescribing particular corporate structures and complying with a number of hard and fast rules. There is a need for broad principles. All concerned should then apply these flexibly and with common sense to the varying circumstances of individual [retirement funds].

Governance is also not a matter of box ticking as to whether the rules/processes have been complied with; the rules/processes are not an end in themselves, but a means to an end - instruments in the pursuit of the true objective namely to ensure that the best interests of the [Fund] and its members are at all times served.”

However governance rules and processes “will always be far less important for [fund] success and for the avoidance of disaster than having properly informed [trustees] of the right calibre, bringing openness, thoroughness and objectivity to bear on the carrying out of their roles.”

WHAT WE EXPECT FROM THE SPONSOR

May I in conclusion add the following gloss to the Hampel statement:

- And having a sponsor of the right calibre
 - who understands its duty of good faith to the fund and its members;
 - who cherishes and nurtures an excellent relationship with the trustees, characterised by respect, openness, accountability and support
 - who serves the fund and its members with excellence and integrity.

Thank you

QUESTIONS ARE WELCOME

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Speaker Tashia Jithoo

Company Hunter Law

Topic The impact of reinstatement orders on pension funds

Section 193 Remedies for Unfair Dismissal from Employment

1. Reinstatement OR

2. Re-employment

Unless (a) employee does not want it; (b) continued employment relationship is intolerable; (c) not reasonably practical for employer or (d) only procedurally unfair (but substantively fair)

In which case

3. **Compensation** not exceeding the equivalent of 12 months salary or 24 month's salary if automatically unfair dismissals (s193(1)(c) read with s194)

Are all mutually exclusive remedies (Constitutional Court in *Equity Aviation*)

Re-instatement Orders

- (a) Can be from date of dismissal, from date after dismissal (DD) or from date of court or arbitrator's order (DO)
- (b) No limit on retrospectivity because back-pay not compensation (CC in *Equity Aviation*, SCA in *Republican Press*, LAC in *Kroukam* and but conflicting LAC decision in *CWIU v Latex Surgical Products*)
- (c) Restores old contract on same terms and conditions
- (d) All employment rights accrued under old contract preserved (eg. leave, seniority, years of service) & back-pay due from ED-R
- (e) Legal effect if reinstated from date **after** DD? Same as above but no service and no benefits for period between DD and ED-R

Re-employment Orders

- (a) New employment contract so break in employment
- (b) Accrued rights iro previous employment period forfeited
- (c) Back-pay from ED-R
- (d) Can change terms and conditions of employment

Need a framework

(a) Many fund issues that are impacted upon

(b) Need sound framework for considering issues that is based on clear principles so that consistent approach

(c) In attempting to establish framework, will look at four issues:

- Recovery of benefits paid & adjustment of future benefit liability and pensionable service
- Membership
- Contributions
- Retrospective benefits

(d) Key issue: Whether a finding of unfairness or order of reinstatement nullify the dismissal?

Does a finding of unfairness or order of reinstatement nullify the dismissal?

(a) Seen in language used by courts, arbitrators and adjudicator. For eg,

dismissal is declared **null and void and set aside**'

'The legal effect of reinstatement is that the unlawful dismissal is deemed never to have taken to have occurred. Therefore **reliance on such dismissal by the fund to determine the benefit payable to the complainant is reliance on a contingency which never arose in law.**' (*Sathegke v Orion Money Purchase Fund (SA) & another (1)* ; *Pather v Tongaat-Hullett Pension Fund*)

(b) Assumption that if reinstated dismissal is legally regarded never to have happened

(c) Employer & all third parties must simply undo consequences of that dismissal regardless of how long ago it happened or regulatory regime that governs them

Does a finding of unfairness or order of reinstatement nullify the dismissal? Alternate approach?

(d) Finding of unfairness **does not wipe out the fact of a dismissal** – simply declares it unlawful

(e) Result regulated by s193 which offers different ways to address consequences of the dismissal

(f) Thinking echoed in *Union of Metal Workers & others v Henred Freunhauf Trailers (Pty) Ltd* 1995 (4) SA 456 (A)

‘Where an employee is unfairly dismissed he suffers a wrong. Fairness and justice require that such wrong be redressed. The Act provides that the redress may consist of reinstatement, compensation or otherwise.’

(g) If re-employment or compensation or reinstatement to date after DD ordered – fact of dismissal still stands

Does a finding of unfairness or order of reinstatement nullify the dismissal?

(h) Full retrospective reinstatement also does not wipe out **fact** of dismissal because:

- Whether dismissal is nullified cannot depend on what remedy is chosen
- Difference between

(i) stg aimed at treating employee “as if” dismissal did not occur and so seeking to correct consequences of dismissal as fully as possible, and

(ii) saying that dismissal is **legally** regarded as never having happened

(i) Reinstatement is a remedy that seeks (a) but cannot have the effect of (b).

Does a finding of unfairness or order of reinstatement nullify the dismissal?

Hilton Kramer v Pension Funds Adjudicator & another [2005] 11 BPLR 915 (W)

- (a) Employee disabled before retirement. Employer-owned policy entitled him to disability benefit. Fund rule stated that membership continued as long as received disability benefit ito policy.
- (b) Insurer stopped benefit so membership ceased. Benefit reinstated following arbitration.
- (c) Court upheld fund argument that that membership did not resume because despite reinstatement of benefit, rule said membership terminates if benefit terminates & benefit had terminated and so membership had terminated
- (d) Court held that funds need certainty re whether benefit or contributions due & cannot be caught in employer-employee disputes
- (e) Fact of termination not legality of termination was important here

If Dismissal is Nullified: Recovery and adjustment of future benefit liability

- (a) Fund would have to recover any benefit that was paid with interest – unjustified enrichment claim - but cost and time
- (b) If member unable to pay/fund unable to recover benefit, how to adjust future benefit liability?
 - (i) **Adjust now:** DB fund - could reduce years of service; DC fund - reduce fund credit but both prohibited by s37A because not authorised deduction from MIR
 - (ii) **Set-off from future benefit entitlement** – but prohibited by s37A because not authorised deduction
 - (iii) **Registrar's approval as deduction ito s37D(1)(c)(iii)** - not possible as contemplates pmts to third parties obo member not to member him/herself

If Dismissal is Nullified: Recovery and adjustment of future benefit liability

Options that may work:

(a) Rule saying that if member is **challenging fairness of dismissal, fund will withhold benefit** until finally determined

- Fairness to member? Choice between chance of getting back job or compensation
OR benefit to sustain self and family while unemployed

(b) Agreement between employer, fund and employee at time of dismissal that **reinstatement is conditional upon pay-back of benefit** (*Babcock Engineering Contractors (EDMS) Bpk v President, Industrial Court & Another* (1993) 14 ILJ 111 (T))

- will save the fund time and cost of litigation
- but employee in difficult position if cannot pay

Recovery and adjustment of future benefit liability: If Dismissal is Nullified

(c) Could payment be regarded as an **advance** at time that calculating benefit entitlement?

- Does it matter that no ongoing benefit entitlement?
- Is it simply a different way to allow a set-off? Or make a loan?
- Would SARS object? Tax adjustment later on when full benefit paid?
- If advance is possible, actuarial calculations to factor in member use of money and that fund could not earn return on money

(d) Best would be **legislative change to s37D** allowing deduction of withdrawal benefits if member reinstated and benefit not repaid to fund

Recovery and adjustment of future benefit liability: If Dismissal NOT Nullified

(a) No obligation to recover any benefit paid because fact of dismissal remains so not ultra vires

(b) Beneficial to fund – eliminates time, cost & difficulties of recovery

(c) Beneficial to member who may not have the money to pay back. Benefits start accruing afresh.

(d) But rules can also allow member who wants to pay back to do so

- DC fund – treat as AVC
- DB fund – treat as purchase of pensionable service

Membership: If Dismissal is Nullified

- (a) Membership restored automatically because dismissal never occurred
- (b) Not a new member for purposes of insured benefits so disclosure requirements do not apply on reinstatement (*Pather v Tongaat-Hullett Pension Fund*)
- (c) No interruption in membership (eg entitlement to benefit if were a member before X date)

Membership: If Dismissal NOT Nullified

(a) Membership restored automatically because employment contract restored & membership is condition of employment

(b) For ITA purposes – fund membership must be compulsory for all eligible employees

(c) But because was interruption of service (because fact of dismissal remains), would be new member for purposes of insured benefits or other rights

Option: Rules say that if readmitted to fund on account of reinstatement, deemed not to be a new member

Contributions: If Dismissal is/is not Nullified

(a) Arrear contributions **automatically due from DR even if not specified in reinstatement order** because

(i) Contributions are part of remuneration and all back-pay contractually payable (*Swanepoel v Abraham & Gross Provident Fund & Another* (PFA); *Parry v Cleaver* (UK); *GN 691* as determined to s35(5) of the BCEA)

(ii) s13A requires payment of contributions as soon as become a member

(b) *Mgwebi v UNISA* (PFA) illustrates prejudice for employees/members when non-payment of arrear contributions following reinstatement is treated differently from normal case of non-payment of contributions.

Contributions: If Dismissal is/is not Nullified

Is late payment interest due on arrear contributions?

- (a) Monthly contributions due by 7th day of following month (s13A(3))
- (b) Late payment interest “shall” be payable from 8th day on a compound basis (s13A(7) read with reg 33(7))
- (c) No limit on retrospectivity of reinstatement order + compound interest = potentially huge financial burden on employer, which could affect business and other employees
- (d) Argument that purposive interpretation requires interest from when back-pay due because no earlier obligation to pay contributions
- (e) But member negatively affected if DC because no return on contributions and no late payment interest that fund can use to credit member with return
- (f) And fund affected if DB because full benefit liability remains despite fund not having been able to receive return from those contributions to fund benefit

Retrospective Benefits: If Dismissal is/is not Nullified

- (a) Benefit entitlements that arise in period between ED-R & DO
- (b) Not a member at time but retrospective reinstatement could create retrospective entitlement eg, death, disability
- (c) If benefits self-funded – same as other benefit entitlements
- (d) If insured benefits (and fund liability limited to what insurer pays)
 - Despite membership, non-payment of premiums may cause cover to lapse
 - Waiting periods may have expired
- (e) Funds should try to negotiate upfront with insurers that
 - In these special circumstances so long as arrear premiums brought up to date, member will be covered
 - Waiting periods will be waived or adjusted

Comparison of biggest problems of each approach

	RECOVERY & ADJUSTMENT	MEMBERSHIP	CONTRIBUTIONS	RETROSPECTIVE BENEFITS
IF DISMISSAL NULLIFIED	<p>Recovery of benefit</p> <p>How to adjust future liability if can't recover benefit</p> <p>Solution: Agmt that reinstatement conditional on refund of benefit</p> <p>Maybe regard as advance pmt???</p> <p>Legislative change to PFA to recognise as deduction</p>		Late payment interest ?	Negotiate cover with insurer
IF DISMISSAL NOT NULLIFIED		<p>New member for insured benefit disclosure & other entitlements</p> <p>Solution: Rules deems reinstated member not be new member</p>	Late payment interest ?	Negotiate cover with insurer

Thank you

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Speaker Mickey Lowther

Company Actuary Mickey Lowther

Topic The new draft Regulation 28 – Prudential
Investment Guidelines for Retirement Funds

ICA 2010 KEYNOTE SPEAKERS ASKED:

- WHY DIDN'T ACTUARIES PREVENT THE CRISIS?
- WHAT ARE YOU DOING TO PREVENT THE NEXT CRISIS?

REGULATION 28: WILL IT PREVENT THE NEXT CRISIS?

Agenda

- Investment 101: Matching assets & liabilities
- Regulator's oversight: Rules or principles?
 - Looking Back
 - Proposed changes
 - Industry reactions

MATCHING ASSETS & LIABILITIES

- Purpose of funds – Retirement, death and other benefits
- Purpose of investing – At least match liabilities
- Different funds → Different liabilities → Different investments
- DB vs DC → Difference includes guarantees
- Retail vs Employment-based → Difference includes member needs
- Should the regulator get involved?
- Leave it to the actuaries and their models?

RULES OR PRINCIPLES?

RULES

- Glass Seagall Act
- 2nd King Code of Governance
- Older Professional Codes
- Bankers remuneration

PRINCIPLES

- Repeal of Glass Seagall Act
- 3rd King Code of Governance
- Newer Professional Codes

“The limitations of a pure principles based regime have to be recognised ... a principles based approach does not work with individuals who have no principles.” *HectorSants, FSA CEO, 2009*

LOOKING BACK

- Funds had to hold 50% Prescribed Assets until 1982
 - Regulation 28 then filled the void
 - Principles-based draft considered but rejected
 - Served us well?

*The current draft has urgent amendments only.
A holistic review is part of Pensions Reform.*

PROPOSED CHANGES include ...

- Funds offering choice must comply at member-level
- Funds must look through structured investments to underlying assets
- Credit rating of assets introduced
- Islamic ‘equivalent’ liquid assets defined
- Derivatives and asset lending allowed for efficient portfolio management
- Property trusts classified as equity
- Linked insurance policies must comply
- Offshore limited to 20% plus another 5% into Africa

But PROPOSED CHANGES exclude ...

- Environmental / Social / Governance issues
- Regulation of hedge funds
- Exchange Traded Funds



SYSTEMS



COMPLIANCE



MATCHING



THE LOT!



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Treasury Road Show

Treasury acknowledged

- inherited an imperfect rules-based system
- past relationships with industry not ideal
- industry is at the coal-face of these issues

They genuinely want to consult whether the draft gives effect to their intentions.

12000 funds must reduce to 500 before principles based regulation will work

Thank you
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